NO. 80359-5

CERTIFICATION FROM THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE
IN

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Plaintiff,

vs.

ONVIA, INC., ONVIA.COM, and RESPONSIVE MANAGEMENT SYSTEMS, in its individual capacity and as class representative of a purported settlement class,

Defendants.

REPLY BRIEF OF PLAINTIFF ST. PAUL FIRE AND MARINE INSURANCE COMPANY

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I. INTRODUCTION

Reading RMS's brief, with its recurring theme that the certified questions before the Court have already been decided under Washington law, one might wonder why the District Court bothered to certify the questions in the first place. The answer becomes clear, however, when one realizes that RMS wants this Court to decide questions different than the ones the District Court asked. With respect to Question (1), it subtly substitutes the general phrase "no coverage"[1] in place of the more specific phrase "no duty to defend, indemnify or settle." It then cites inapposite cases from this Court, the Court of Appeals, and even cases from other jurisdictions finding bad faith or considering bad faith claims when there was no ultimate duty to *indemnify* but where the insurer had a duty to defend or investigate.[2] These cases are not controlling as to Question (1). The only courts that have directly addressed Question (1) are California's, which have ruled that there can be no bad faith in processing a claim when there is no duty to defend.[3] RMS's evasion of the District Court's

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[1] See for example, RMS's Summary of Argument pertaining to Question (1) and its argumentative headings relating Question (1).

[2] While this is generally the case, RMS sometimes misrepresents the facts in its key cases and suggests that the duty to defend was at issue. For instance, in RMS's discussion of Torina Fine Homes, Inc. v. Mutual of Enumclaw Ins. Co., 118 Wn. App. 12, 74 P.3d 648 (2003), an "underlying complaint" against the insured appears, Resp. Br. at 5, when in reality, it did not exist. See *infra* at 5.

[3] Waller v. Truck Ins. Exchange, Inc., 11 Cal. 4th 1, 44 Cal. Rptr. 2d 370 (1995); Buena Vista Mines, Inc. v. Industrial Indem. Co., 87 Cal. App. 4th 482, 488, 104 Cal. Rptr. 2d 557 (2001) ("where there is 'no potential for coverage and, hence, no duty to defend under the terms of the policy, there can be no action for breach of the

question by answering a different one shows that there is no justification for allowing bad faith claims when the lack of a duty to defend is clear from the face of the complaint against the insured. St. Paul's answer to Question (1) is direct, supported, and sound; RMS's is not.

RMS's strategy with respect to Questions 2(a) and 2(b) is the same. It does not discuss why the presumption of harm and coverage by estoppel *should* be extended to a case where the insurer has no duty to defend. Instead, RMS pretends that this Court mechanically applies these doctrines to all third party cases regardless of what is at stake. This Court's common law rules are supported by reasons and are not blindly applied without reference to those reasons. But that — rubber-stamp jurisprudence — is what RMS advocates. RMS's mere quotation to broad language used by this Court in different contexts does not justify applying the holdings of those decisions to these facts,[4] particularly because just three months ago this Court acknowledged that it has not decided whether the presumption of harm applies beyond the context of misconduct

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implied covenant of good faith and fair dealing'"); R & B Auto Center, Inc. v. Farmers Group, Inc.,140 Cal. App. 4th 327, 44 Cal. Rptr. 3d 426 (2006) ("when there is no potential for coverage, a cause of action for bad faith in the investigation and processing of a claim will not lie.").

[4] Adair v. Weinberg, 79 Wn.App. 197, 203, 901 P.2d 340 (1995) ("language taken out of the context of an appellate opinion may not serve as the theme of an argument that distorts the law").

relating to the defense of the insured.[5] The Court should now rule that presumed harm and coverage by estoppel do not apply when the insurer did not defend and had no duty to do so. Again, St. Paul's answers are direct, supported and sound; RMS's are not.

Insureds do not need tort remedies to protect their right to receive nothing. Insureds are not denied the security purchased in their insurance contracts when there is clearly no security the insurer can provide. Because bad faith is unreasonable or frivolous conduct that overemphasizes the insurer's interests at the expense of the insured's competing interests, bad faith cannot exist when the insured has no interest to weigh. The Court should therefore answer Question (1) in the negative, or, if it does not, it should answer Question (2) by requiring that the insured prove actual harm and damages resulting from the insurer's conduct.

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[5] Mutual of Enumclaw Ins. Co. v. Dan Paulson Const., Inc., __ Wn.2d__, 169 P.3d 1, 12 (2007) ("presumption of harm has previously been applied where the insurer's bad faith was associated with its underlying defense of the insured").

II. ARGUMENT

A. RMS's Argument on Question (1) is Evasive, and Fraught with Mischaracterizations and Misapplications of Washington Law.

1. To dodge the real issue, RMS attempts to change Question (1) through wordplay.

RMS contends that "existing Washington law allows procedural bad faith and CPA claims in the absence of coverage."[6] The term "procedural bad faith" is one coined by RMS in its complaint and does not appear in any Washington case. From RMS's use of the phrase, it appears to mean a claim for bad faith based upon any ground other than a wrongful denial of coverage.[7] It is clear therefore, that a case is not necessarily helpful to the analysis here merely because it involves what RMS calls "procedural bad faith" unless the case also involves a finding of no duty to defend. None of the cases RMS cites as examples of procedural bad faith fit these criteria.[8] It does not follow that because an insurer can commit

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[6] Br. of Resp. at 4.

[7] RMS's claim for "substantive" bad faith based on wrongful refusal to defend was dismissed on summary judgment.

[8] Br. of Resp. at 7 (citing Coventry Associates v. American States Ins. Co., 136 Wn.2d 269, 279, 961 P.2d 933 (1998) (first party insurer with duty to investigate but no ultimate duty to indemnify); Rizzuti v. Basin Travel Serv. of Othello, 125 Wn. App. 602, 618, 105 P.3d 1012 (2005) (same)); Br. of Resp. at 9 (citing Tadlock Painting Co. v. Maryland Cas. Co., 322 S.C. 498, 500, 473 S.E.2d 52 (S.C. 1996) (consequential damages to insured caused by insurer's bad faith failure to settle non-litigated third party claim were not foreclosed by the fact that the insured settled the claims within the deductible); State Farm Mut. Auto. Ins. Co. v. Shrader, 882 P.2d 813, 819 (Wyo. 1994) (dispute over amount of indemnification due under first party underinsured motorist policy)); Br. of Resp. at 17-18 (citing Deese v. State Farm Mut. Auto. Ins. Co., 172 Ariz. 504, 509, 838 P.2d 1265 (Ariz.1992) (alleged bad faith investigation of first party

bad faith by poorly performing a reservation of rights defense, or by failing to conduct a proper investigation of a first party claim in the absence of a duty to indemnify, that an insurer can also commit bad faith in administratively mis-processing a tender when it does not even have a duty to defend.

In the same vein, RMS uses the slippery phrases "absence of coverage" or "no coverage" as substitutes for the District Court's question involving "no duty to defend, indemnify or settle." RMS includes in these phrases cases where there is a potential for coverage, creating a duty to defend or investigate, but no ultimate duty to indemnify.[9] Again, these cases are not on point because they do not address the lack of a duty to defend and the lack of even the potential for coverage that prompted the District Court to submit these certified questions. Instead of arguing why cases involving the lack of a duty to indemnify should be extended to cases involving the lack of a duty to defend, RMS pretends the two are obviously the same and therefore provides this Court with no meaningful analysis.

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medical payments benefits by use of biased medical reviewers); White v. Unigard Mut. Ins. Co., 112 Idaho 94, 95, 730 P.2d 1014 (1986) (alleged bad faith investigation of first party fire loss)); Br. of Resp. at 20 (citing Rawlings v. Apodaca, 151 Ariz. 149, 153, 726 P.2d 565 (Ariz.1986) (insurer paid $10,000 first party policy limits for fire loss but concealed the fact that its investigation revealed that neighbor who carried liability insurance with the same insurer was liable for the fire)).

[9] See note 8, supra.

2. The Torina Fine Homes case is not on point and RMS misstates its facts.

One possible source of RMS's error is its apparent (and mistaken) belief that the Court of Appeals in Torina Fine Homes, Inc. v. Mutual of Enumclaw Ins. Co.,[10] ruled in favor of its position on this question. RMS's heavy reliance on this case is puzzling. RMS's statement that "the insured builder tendered an underlying complaint for construction defects to its liability insurer"[11] is simply false. There never was a complaint, only a claim. Torina did not involve the duty to defend because there was no lawsuit against the insured. The insured resolved the claim on its own by agreeing to repair certain claimed defects, and then sought reimbursement from its insurer and a subcontractor:

> [B]uyers Stephen and Kay-Dawn Jenkins (Jenkins) requested that Torina repair water damage to their deck. An inspection revealed that a subcontractor had improperly installed the synthetic stucco siding. This mistake caused significant water damage to the home's framing. Eventually TFH repaired this damage.
>
> In August 2000, TFH made a claim on its Mutual of Enumclaw commercial general liability policy, and brought a claim against the subcontractor who installed the stucco siding.[12]

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[10] 118 Wn. App. 12, 74 P.3d 648 (2003)

[11] Br. of Resp. at 5.

[12] Torina, 118 Wn.App. at 14-15 (emphasis added).

Significantly, the court noted that because the insured's defense was not at issue, coverage by estoppel was not an available remedy:

> It is well established that "an insurer that refuses or fails to defend in bad faith is estopped from denying coverage."[ ]
>
> But here there was no refusal to defend, only the refusal to indemnify. And our courts have consistently held that the duty to indemnify hinges on the insured's actual liability to the claimant and actual coverage under the policy.[ ] The initial denial of coverage here, based on a mistake of fact which TFH could easily have corrected, did not result in prejudice that rises to the level of estoppel.[13]

If anything, Torina is irrelevant to question (1) and supports St. Paul's position on questions (2)(a) and (b). That the Torina court assumed that the Coventry[14] standard applied is unremarkable. The claim in Torina was essentially a first party claim under a third party liability policy. The insured was never sued; it resolved the claim on its own and then presented the resolved claim to the insurer as its own claim for reimbursement.[15] Because there was no complaint, coverage did not turn on a comparison between the complaint and the policy. Rather, the insurer

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[13] Torina, 118 Wn.App. at 18.

[14] Coventry Associates v. American States Insurance Co., 136 Wn.2d 269, 961 P.2d 933 (1998).

[15] The insured's settlement of the claim before tendering it to the insurer would ordinarily constitute a breach of the insurance contract and grounds to reject the claim. See Key Tronic Corp. v. St. Paul Fire & Marine Ins. Co., 134 Wn.App. 303, 304, 139 P.3d 383 (2006).

could evaluate coverage only by investigating the cause of the loss and determining whether it fell within coverage just as it would with a first party claim. Under Coventry, it had a duty to perform this investigation in a good faith, non-biased fashion.

Thus, Torina is not analogous to the case at bar, and to the extent it applies at all, it supports St. Paul's position that no estoppel applies.

3. This Court's ruling in Coventry did not assume the existence of a cause of action under these facts.

RMS wrongly argues that the Coventry ruling assumes that there is a claim for bad faith under the facts presented here.[16] The portion of Coventry relied on by RMS actually dealt with the presumption of harm, and not with the existence of a claim for bad faith in the absence of a duty to defend under a third party liability policy.[17] It would in fact be an extension of Coventry to hold that a liability insurer could commit bad faith in administratively processing a claim that it had no duty to defend. Coventry dealt with an insurer that allegedly failed to investigate a potentially-covered property claim – thus wrongly forcing its insured to conduct the investigation, much like a liability insurer that wrongfully refuses to defend forces its insured to defend itself. The insurer in Coventry had much more substantial duties than St. Paul did in this case.

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[16] Br. of Resp. pp. 7-10.

[17] Coventry, 136 Wn.2d at 277.

4. RMS loses sight of what bad faith is.

While RMS writes at length about "procedural" and "substantive" bad faith,[18] it does not explain how an insurer with no duty to defend can engage in conduct that meets this Court's long established definition of "bad faith." Bad faith is not a strict liability tort that can be founded on a mere claims processing error or regulatory violation[19] that allows the insured (or its assignee) to say "gotcha" and collect $17 million on a clearly non-covered claim. Good or bad faith, depending on how the issue is framed, has been described by Washington courts in a consistent fashion. The good faith duty has been described as a duty to "refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk,"[20] or as a duty to "deal fairly with an insured, giving equal consideration in all matters to the insured's interests as well as its own,"[21] or bad faith as a case where an "insurer . . . overemphasizes its own interests."[22] The tort is committed when the insurer, through unreasonable or frivolous conduct,

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[18] Br. of Resp. at pp. 8-11.

[19] It is only when an insurer fails to comply with its statutory obligation under circumstances that amount to bad faith that a cause of action exists. Coventry, 136 Wn.2d at 281 ("When the insurer does not comply with [statutory] obligations in bad faith, a cause of action exists.") (emphasis added).

[20] Paulson, 169 P.3d at 8 quoting Tank v. State Farm Fire & Cas. Co., 105 Wn.2d 381, 383, 715 P.2d 1133 (1986).

[21] Van Noy v. State Farm Mut. Auto. Ins. Co., 142 Wn.2d 784, 793, 16 P.3d 574 (2001)

demonstrates greater concern for its monetary interest than the insured's financial risk.[23] In order for bad faith to exist, an insurance company must (1) be faced with a situation involving a balance or a conflict between its interests and those of the insured and (2) unreasonably resolve the conflict in its own favor.

Bad faith, therefore, necessarily requires conflicting interests, not just unreasonable conduct. The potential for such conflicts of interest is inherent in the order and nature of performance unique to insurance contracts. An insured pays a relatively small premium up front in order to insure against the contingency of much greater losses in the future. If a covered claim is made, the contract is almost certainly a losing one for the insurer because losses will dwarf both the premium paid and the value of the insured's goodwill and continued business. An insurer therefore has a monetary interest in contending that a claim is not covered by the contract or in taking other actions to minimize or avoid claim payments and expenses. Examples include:

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[22] Anderson v. State Farm Mut. Ins. Co., 101 Wn.App. 323, 329, 2 P.3d 1029 (2000).

[23] Paulson, 169 P.3d at 8 (insurer had duty to "refrain from engaging in any 'unreasonable, frivolous, or unfounded,' [] 'action which would demonstrate a greater concern for [insurer's] monetary interest than for [insured's] financial risk.'")

- Unreasonably denying or refusing to acknowledge a clearly covered claim in hopes that the insured will accept the result or that the claim will simply "go away."[24]
- Refusing to settle a covered liability claim within the policy limits despite the risk of an excess judgment, when a reasonable insurer would accept the offer if there were no policy limits.[25]
- While defending an insured under a reservation of rights, taking actions to negate a duty to indemnify that are prejudicial to the insured's defense of the tort claim.[26]
- When adjusting a first party property loss, performing an inadequate or biased investigation.[27]

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[24] Truck Ins. Exchange v. Vanport Homes, Inc., 147 Wn.2d 751, 765, 58 P.3d 276 (2002) (insurer with duty to defend should not be "permitted to do nothing in the hope that the insured will go out of business and the claims simply go away"); Kirk v. Mt. Airy Ins. Co., 134 Wn.2d 558, 560, 951 P.2d 1124 (1998) (an insurer acts in bad faith when it refuses to defend its insured and the refusal is "unreasonable, frivolous, or unfounded").

[25] Besel v. Viking Ins. Co., 146 Wn.2d 730, 49 P.3d 887 (2002); Tyler v. Grange Ins. Ass'n, 3 Wn. App. 167, 177, 473 P.2d 193 (1970).

[26] Paulson, 169 P.3d at 7 (insurer's ex parte communications with arbitrator designed to resolve coverage issues prejudiced insured's arbitration hearing); Safeco Ins. Co. of America v. Butler, 118 Wn.2d 383, 395, 823 P.2d 499 (1992) (insurer allegedly delayed defense counsel's investigation in order "enhance its position on the coverage issue.").

[27] Industrial Indem. Co. of the Northwest, Inc. v. Kallevig, 114 Wn.2d 907, 919, 792 P.2d 520 (1990) (insurer committed bad faith by concluding that the insured committed arson after limited investigation and in the face of contrary evidence); Anderson v. State Farm Mut. Ins. Co., 101 Wn. App. 323, 331, 2 P.3d 1029 (2000) (UIM insurer unreasonably accepted as true statements that the insured was negligent while

When there is no duty to defend, the insurer may neglect correspondence or commit errors in processing a tender, but it is impossible for it to demonstrate greater concern for its monetary interest than the insured's financial risk.[28] Two pieces of paper—the policy and the complaint—conclusively establish that neither the insurer's monetary interests nor the insured's financial risk is at issue. In such a situation, there is nothing an insurer can do to opportunistically overemphasize its own interest to the detriment of the insured because the insurer is already fully justified in paying nothing and can elevate its interests no further. If an insurer fails to timely send a letter to an insured confirming that there is no duty to defend, it has not engaged in unreasonable self-dealing; it is simply late.

5. The lack of a bad faith claim does not nullify the claims handling regulations.

It is not the case, as RMS argues, that the absence of a bad faith claim "nullifies" the protections afforded to Washington insureds under the claims handling regulations.[29] As this Court pointed out when it denied a cause of action for bad faith to third party claimants, "[t]he goal

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disregarding contrary evidence in concluding that UIM benefits should not be made available); Coventry, supra (inadequate investigation).

[28] See Waller v. Truck Ins. Exchange, Inc., 11 Cal.4th 1, 36 (1995) (insurer with no duty to defend had no ability to engage "in conduct that frustrates the [insured's] rights to the benefits of the agreement.").

[29] Br. of Resp. at 16.

of the insurance regulations is a well-regulated insurance industry," and "the Insurance Commissioner, not a third party claimant, should have the primary enforcement right."[30] The Insurance Commissioner is empowered by statute to enforce its regulations:

> (5) If the commissioner has cause to believe that any person is violating any such regulation, the commissioner may order such person to cease and desist therefrom. The commissioner shall deliver such order to such person direct or mail it to the person by registered mail with return receipt requested. If the person violates the order after expiration of ten days after the cease and desist order has been received by him or her, he or she may be fined by the commissioner a sum not to exceed two hundred and fifty dollars for each violation committed thereafter.
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> (6) If any such regulation is violated, the commissioner may take such other or additional action as is permitted under the insurance code for violation of a regulation.[31]

RMS's argument wrongfully equates a duty to comply with regulations with the existence of a tort cause of action. An insurer has a regulatory duty to comply with regulations regardless of whether the specific violation gives rise to a private cause of action. And the Insurance

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[30] Tank v. State Farm Fire & Cas. Co., 105 Wn.2d 381, 395, 715 P.2d 1133 (1986).

[31] RCW 48.30.010 (5) and (6).

Commissioner can take action even if the insurer's conduct does not result in harm or damages.

Moreover, bad faith is a general common law standard as described above and is not governed by regulatory time tables.[32] An insurer does not automatically demonstrate greater concern for its own interest than the insured's by responding to a claim in eleven business days instead of ten.[33] By definition, competing interests are required to implicate the duty of good faith and there are no competing interests here. And while violating a regulation establishes the first of five elements of a claim under the Consumer Protection Act,[34] giving the CPA claim more plausibility, the third element, requiring that the conduct impact the public interest, and the fourth element, that the conduct cause injury to the insured's business or property, are markedly absent. The public has no interest in giving pure windfall recoveries to insureds who simply ask for something they are clearly not entitled to; nor does the insured have a

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[32] While the relevance is unclear, RMS states that the new Insurance Fair Claims Act, which became effective on December 6, 2007, recognizes "a separate cause of action for procedural bad faith." This is not true. The Act requires that a first party claimant be "unreasonably denied a claim for coverage or payment of benefits by an insurer," in order to have a cause of action. RCW 48.30.015(1). If those elements are met, then regulatory violations can be used to justify an award of attorney fees or treble damages. There is no cause of action independent of a substantively wrongful deprivation of coverage or benefits.

[33] See WAC 284-30-360(1).

[34] Under the CPA, a private citizen must show (1) an unfair or deceptive act or practice, (2) in trade or commerce, (3) that impacts the public interest, (4) which causes injury to the party in his business or property, and (5) which injury is causally linked to the unfair or deceptive act. Kallevig, 114 Wn.2d at 920-921.

business or property interest in the policy to protect. In any event, this Court has made clear that a regulatory violation is not the same as a claim for bad faith.[35]

Lacking any substantial argument, RMS resorts to casting itself as a victim, stating that "unfortunately for RMS, St. Paul has chosen to litigate this case in five separate state and federal courts."[36] In actual fact, the theoretically-injured company known as RMS has only a tiny stake in this lawsuit as a class representative and recipient of a single fax. The real party in interest, class counsel, is a repeat player in attempts to combine the TCPA, the class action mechanism, and this state's law into an insurance super lotto.[37] This Court should not be swayed by appeals to sympathy any more than it should be persuaded by fallacious arguments.

B. RMS Provides No Justification for Applying a Presumption of Harm.

The only argument RMS advances in support of applying the presumption of harm is a demonstrably false assertion that "[t]his Court

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[35] Hayden v. Mutual of Enumclaw Ins. Co., 141 Wn.2d 55, 62, 1 P.3d 1167 (2000) (regulatory violation did not preclude coverage defenses not raised in denial letter in the absence of prejudice or bad faith).

[36] To clarify the record, while St. Paul filed the federal court case, it was the district court that *sua sponte* certified these questions to this Court and it was RMS that appealed its loss on the duty to defend question to the Ninth Circuit.

[37] In Utica Mut. Ins. Co. v. Lifequotes, et al., No 2:06-CV-00228-EFS (E.D. Wash.), for example, counsel of record in this case is attempting to collect as much as $95,201,000 based on similar fax-related "bad faith" claims. See id at Dkt. No. 112 at 4 (claiming newly discovered evidence supports supplement to court-approved $8,949,000 judgment).

has already ruled on the second Certified Question."[38] RMS points to no example of a decision by this Court holding that the presumption of harm extends to an insurer that did not defend or had no duty to defend. Instead it points to broad language from this Court's decision in Besel, where the Court stated that:

> Viking further argues *Butler's* presumption of harm should not apply because *Butler* involved a defense tendered under a reservation of rights. This is a distinction without a difference. The principles in *Butler* do not depend on how an insurer acted in bad faith. Rather, the principles apply whenever an insurer acts in bad faith, whether by poorly defending a claim under a reservation of rights, *Butler,* 118 Wn.2d at 390-92, 823 P.2d 499; refusing to defend a claim, *Kirk v. Mt. Airy Insurance Co.,* 134 Wn.2d 558, 565, 951 P.2d 1124 (1998); or failing to properly investigate a claim; *Coventry Associates v. American States Insurance Co.,* 136 Wn.2d 269, 961 P.2d 933 (1998).[39]

The "whenever" language in the Besel opinion is dicta to the extent it is read to mean something more that that the presumption of harm is not limited to reservation of rights defenses. The examples given by this Court in Besel also involved deprivation of significant policy benefits, such as the duty to defend in Kirk, the duty to conduct a scrupulous

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[38] Br. of Resp. at 23.

[39] Besel v. Viking Ins. Co. of Wisconsin, 146 Wn.2d 730, 737, 49 P.3d 887 (2002).

reservation of rights defense in Butler, and the failure to settle covered claim in Besel itself.

RMS's reliance on similar language in Butler is even more misguided. In its full context, it is clear that the Butler court's discussion was limited to an analysis of a Court of Appeals case involving the potential for prejudice to the insured resulting from the insured's loss of control of the defense:

> Any case in which the insurer actually acted in bad faith is an "extreme case" within the meaning of *R.A. Hanson.* Therefore, we presume prejudice in any case in which the insurer acted in bad faith. There is no conflict with *R.A. Hanson* because there the insurer did not act in bad faith.[40]

While RMS would be wrong in any event to rely solely on dicta from Besel and the out of context citation to Butler to justify the result it seeks, this reliance is particularly misplaced after this Court's recent ruling in Paulson. In Paulson, this Court stated that "we emphasize that while we are not retreating from Butler, neither are we extending it. The presumption of harm has previously been applied where the insurer's bad faith was associated with its underlying defense of the insured."[41] This

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[40] Safeco Ins. Co. of America v. Butler 118 Wn.2d 383, 391, 823 P.2d 499 (1992).

[41] Paulson, 169 P.3d at 12.

Court found that the presumption applied only after finding that the insurer's conduct was directly connected to the insured's defense:

> MOE's bad faith conduct, although perpetrated by its coverage counsel, was intrinsically associated with its underlying defense of DPCI. The conduct cannot reasonably be segregated from that defense- it occurred while MOE was actively defending DPCI and interfered directly in that defense.[42]

RMS's assumption that Butler extends to cases where there was neither a defense nor a duty to defend is unfounded.

While RMS ignores this Court's recent discussion of the breadth of the presumption of harm in Paulson, it does suggest that the Court's application of the presumption to the facts in Paulson also supports applying the presumption here. Paulson is clearly distinguishable. In Paulson the insured was being defended under a reservation of rights in an arbitration hearing. The insurer committed bad faith by sending *ex parte* communications and subpoenas to the arbitrator in an attempt to force the arbitrator to make fact findings that would determine whether the insurer had a duty to indemnify.[43] The insurer's conduct placed the validity of the entire arbitration in jeopardy and possibility prejudiced the arbitrator

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[42] Paulson, 169 P.3d at 12 –13.

[43] Paulson, 169 P.3d at 9.

against the insured.[44] This type of misconduct in handling the insured's defense is not comparable to the situation here because Onvia maintained control of the defense and St. Paul rightly took no part in the defense.

RMS quotes extensively from the reasoning supporting the Butler presumption but fails to analyze why those reasons apply to these facts. It simply states that "the same public policy interests supporting use of the rebuttable presumption of harm in this case [sic]."[45] Why? The rebuttable presumption of harm is *not* given to the insured because harm is implausible and the presumption is needed to save an otherwise frivolous claim. Rather, the presumption is used because the insurer's conduct put the insured at a disadvantage in the tort case and it is usually difficult to prove whether the disadvantage changed the outcome of the tort lawsuit or not.[46]

RMS accuses St. Paul of "misunderstanding Washington law" by arguing that "'there is no reason to suspect that events would have transpired differently' had there been no procedural bad faith."[47] It is RMS that has misunderstood. The presumption of harm is applied in third party cases because it is believed that in such cases the insurer, at

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[44] Paulson, 169 P.3d at 12.

[45] Br. of Resp. at 24.

[46] "As between the insured and the insurer, it is the insurer that controls whether it acts in good faith or bad. Therefore, it is the insurer that appropriately bears the burden of proof with respect to the consequences of that conduct." Paulson, 169 P.3d at 11.

[47] Br. of Resp. at p. 20.

least potentially, "contributes to the insured's loss by failing to fulfill its obligation in some way."[48] By this the Court meant that the insurer enhances the insured's risk of loss by the way it handles the claim.[49] RMS's argument fails to understand the difference between an enhanced risk of loss and ultimate proof of harm in fact.

The nature of this difference can be illustrated by a game analogy. Assume that instead of a lawsuit, the insured is playing chess with the third party claimant. Before the game starts, the insurer wrongfully takes away one of the insured's knights. This conduct undoubtedly increased the insured's risk of losing the game but is not itself proof of actual harm. If the insured loses the match, it would be difficult to prove whether the insured would have won if the insurer had not wrongfully taken the knight. Because the insurer is responsible both for its conduct and the resulting causal uncertainty, under the reasoning in Butler, the insurer is assigned the burden of proving that the outcome was unaffected, such as by putting on evidence that the insured was a novice player and the claimant was a master.[50]

But if the players are evenly matched, the insurer will never be able to rebut the presumption. All of this Court's previous presumption

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[48] Coventry, 136 Wn.2d at 284-285, 961 P.2d 933.

[49] See Paulson, 169 P.3d at 12 (insurer's bad faith conduct increased risk for insured's defense).

cases have been like the game analogy above because the insurer's conduct created a disadvantage in the underlying lawsuit either by depriving the insured of assistance owed or by injecting conflicts of interest into the insured's defense.[51] Onvia was not deprived of any advantage that would be helpful to it in its lawsuit against RMS. Nor was there a conflict of interest between St. Paul and Onvia that was injected into the tort lawsuit because Onvia had no interest and St. Paul did not have control of the defense. In the absence of such a disadvantage to the insured, a presumption of resulting harm is not justified.

C. Coverage by Estoppel is Not Justified When there is No Potential for Coverage to Begin With.

RMS again ignores the significance of the certified questions by assuming that the they are already answered.[52] It assumes again that the Butler formula applies to all third party liability cases based upon the dicta in Besel, while ignoring this Court's more considered and more recent contrary comments in Paulson. (See p. 17, supra.)

(continued . . .)

[50] It would be more difficult to rebut the presumption in an actual lawsuit because it is not solely a question of winning or losing but also of the extent of the win or loss.

[51] E.g., Butler (abuse of a reservation of rights defense); Kirk, 134 Wn.2d at 563 ("bad faith breach of the duty to defend wrongfully deprives the insured of a valuable benefit of the insurance contract, and leaves the insured faced with the difficult problem of proving harm."), Besel (bad faith failure to settle), Vanport (bad faith refusal to defend) Paulson (bad faith interference with a reservation of rights defense).

[52] Brief of Resp. at pp. 28-29.

The rationale for applying or not applying coverage by estoppel is similar to the rationale for applying or not applying the presumption of harm. The estoppel remedy merely gives effect to the presumption. Absent coverage by estoppel (or some other arbitrary damages measure such as a statutory penalty), the presumption would be meaningless because the insured would have to prove the equivalent of actual harm in order show actual pecuniary damages. But if the presumption of harm is not applied, then the remedy should be the insured's actual damages. The insured should not be able to say "because I proved that you did not respond to my initial facsimile-transmitted tender, and as a result I had to send it again at a cost of seven cents, you should pay the seventeen million dollar judgment against me." Such an award will serve no remedial purpose.

The punitive justification for coverage by estoppel, touted by RMS, is also an insufficient justification for its application in the absence of the duty to defend. While it is true that "the estoppel remedy . . . gives the insurer a strong disincentive to act in good faith,"[53] this same line of reasoning would support applying the estoppel remedy in first party cases, even though this Court has refused to do so. Instead, this Court recognized that in the first party cases estoppel would serve no remedial

[53] Butler, 118 Wn.2d at 394.

purpose because there is no plausible causal connection between the insurer's alleged conduct and the uninsured loss.[54]

The broader lesson from Coventry is not a mere distinction between first party and third party cases. It is that that in order for the insured's remedy to be the amount of the uninsured loss, the harm must have some potential causal relationship to the uninsured loss. That will never be the case in first party claims, and will only be the case in third party claims when the bad faith increases the insured's exposure to the third party claimant. This Court should hold that coverage by estoppel is not an appropriate remedy in this case because St. Paul had no duty to provide any assistance with Onvia's defense.

III. CONCLUSION

Before this Court are certified questions concerning the remedy, if any, afforded to an insured whose tender of defense was correctly denied, but whose insurer committed an administrative misstep in handling his tender of defense. Having lost on the issue whether St. Paul had a duty to defend, and again on the issue whether St. Paul acted in bad faith, RMS stands in the shoes of that insured, attempting to argue that such an administrative misstep blossoms into a cause of action, and thereafter, a presumption of harm and an estoppel to deny coverage where it never could exist in the first place.

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[54] Coventry, 136 Wn.2d at 284-285.

RMS is wrong. Washington's courts have never recognized a cause of action for so-called "procedural bad faith" in the liability insurance context. Where there is no duty to defend, the insurer's administrative misstep does not deprive the insured of any benefit afforded by the insurance contract, nor does it increase the insured's exposure to his adversary. This Court should not create such a cause of action, but if it does, it should limit the insured's remedy to those specific damages the insured can prove proximately flowed from the procedural misstep. It should not presume harm nor apply an estoppel because there is no reason for doing so.

In sum, RMS's efforts cannot wrestle this case into the category of cases where the insurer's conduct truly placed the insured's interests in jeopardy, so it argues that a claim handling misstep is the same as real bad faith. It is not, just as form is not the same as substance. This Court has a longstanding distaste for arguments elevating form over substance. RMS, having lost on the substance, is making such an argument. This Court should reject it and answer the certified questions as set forth in St. Paul's opening brief.

Respectfully submitted this 10 day of January, 2008.

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CERTIFICATE OF SERVICE

I am a citizen of the United States and a resident of King County. I am over 18 years of age and not a party to this action. My business address is One Convention Place, Suite 1400, 701 Pike Street, Seattle, WA 98101-3927.

On the date indicated below, I caused the attached document to be served via legal messenger upon:

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DATED this 10th day of January, 2008, at Seattle, Washington.

Pamela L. Iverson